THE SUSTAINABLE BANKING ALLIANCE

Lessons learned in engaging financial institutions for climate finance in Colombia and Egypt

BACKGROUND

USAID's Sustainable Banking Alliance (SBA) is a USAID initiative launched at COP27. Under the SBA, USAID partners with Financial Institutions (FIs) to build their capacity to measure, report, and mitigate their exposure to climate-related risks and to decrease their financed greenhouse gas (GHG) emissions. After COP27, USAID initiated SBA pilots in Colombia (under USAID INVEST), Egypt (USAID Business Egypt), and Rwanda (USAID Africa Trade and Investment), with DAI's support. The SBA offers capacity-building and technical assistance activities to FIs to integrate climate finance across their operations. This includes, for instance, developing specialized tools (e.g., Colombia's financed emissions calculator for FIs) or group FI training to prepare for upcoming climate-related regulations (e.g., Egypt's Central Bank Sustainability Circular published in 2022). These efforts are part of a broader agenda and activities implemented in combination with the public sector, development financial institutions, and public and private donors – all seeking to transform FIs and enable them to incorporate climate risks and emissions-reduction targets in economic and financial decisions and prioritize resilient and low emissions investments. While it is too early to showcase impact outcomes at COP28, this document presents early-stage lessons learned and identifies opportunities to integrate climate finance in FIs based on ongoing activities in Colombia and Egypt, where the pilots are more advanced.

CLIMATE FINANCE CAPACITY BUILDING TO FIS NEEDS TO BECOME A HOLISTIC VALUE PROPOSITION

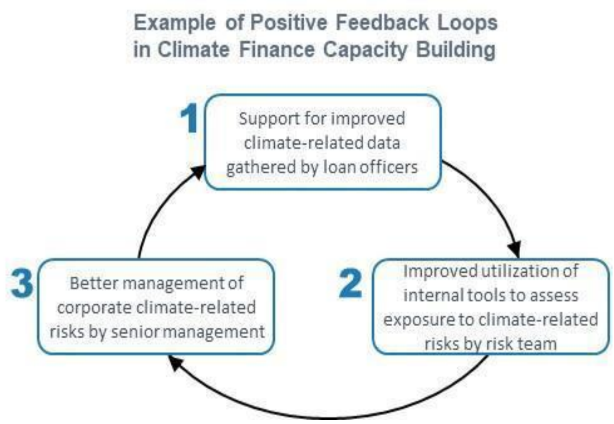
FI capacity building and technical assistance should be designed to ensure climate finance can become an engine for FI's long-term growth and profitability. The interventions to support FIs need to be designed as a holistic value proposition that responds to the unique needs of multiple teams within each FI and how each team plays a differentiated role in incorporating climate finance into the FI, not as an individualized training program.

Lesson 1: Climate finance buy-in requires multiple demand-driven partnerships across teams in a FI.

FIs are complex institutions that include many teams with a broad range of responsibilities. Buy-in for climate finance is driven by requirements from national reporting authorities, by current and expected regulations in key international markets (especially the US and EU), and by global investors, and requires crafting multiple partnerships with different teams and responding to each of their specific capacity building needs and operational challenges. For example, FI risk and reporting staff in Colombia often highlight the need to upgrade FI systems or incorporate tools to measure, and to report the portfolio's exposure to climate-related risks and GHG emissions into their operations and decision-making. Their needs involve identifying cost-efficient and operationally seamless solutions that can be quickly adopted. On the other hand, commercial loan officers typically emphasize the higher complexity of green loan products over non-green loan products and are unclear on the added value of offering one over the other. These officers often request support to simplify green loan product requirements and processes, and capacity building to choose the right (instead of the simplest) green product for prospective borrowers and ultimately grow their loan portfolio. Only by supporting the climate finance needs across key teams within an FI can climate finance become fully integrated across its operations.

USAID INVEST Colombia has developed a calculator to help Colombian FIs estimate their financed GHG emissions, a first step for FIs to establish an emissions baseline and agree on decarbonization targets. The calculator uses the Partnership for Carbon Accounting Financials (PCAF) methodology and includes the four major asset classes for Colombian FIs (project finance, commercial mortgages, residential mortgages, and corporate credit). The tool is currently available to Colombian financial institutions through Colombia's bank association, Asobancaria.

Climate finance interventions can also collectively improve the organization's competitive advantage. FI staff, although belonging to different teams, operate collaboratively and depend on each other. The most successful interventions will drive FI teams' behavioral change and have a positive ripple effect across other teams. Ultimately, the most promising opportunities for institutional change will involve parallel capacity building and technical assistance activities for interconnected teams, which can result in positive feedback loops and mutually reinforcing change across those teams.



Lesson 2: Senior leadership engagements should focus on elevating the individual and collective impact of interventions.

FI senior leadership approaches to climate finance are diverse and range from a relatively narrow focus to meet reporting and regulatory requirements to more sophisticated engagements seeking to advance climate finance as a driver of the company's growth and profits. Strong relationships with senior management often take years to build. Senior leadership is often more open to discussing initiatives that respond to FI's immediate challenges or opportunities and where their strategic guidance is required, especially in the early stages of a partnership. These opportunities may include:

- Identifying additional opportunities for new tools and systems to report and reduce climate-related risks, including potential use for tentative target-setting.
- Breaking silos between the teams benefitting from the climate interventions across the organization and driving positive feedback loops between them.
- Fundraising opportunities tied to climate-related financing initiatives or impact.
- Managing relationships with the public sector (see Lesson 6).

USAID INVEST Colombia purposefully connected the development of a financed GHG emissions calculator with capacity building to FI's risk management staff to deepen the engagement with participating banks. These combined efforts have opened the door to strategic conversations with senior management regarding feasible reductions of financed GHG emissions. Discussions are underway about potential targets.

Lesson 3: FI social inclusion teams need climate finance training to advance an integrated just transition agenda.

Many FIs have increasingly sophisticated inclusion programs targeting women, youth, indigenous people, and marginalized communities, among others. Depending on the country, lack of inclusion can result in increased operational risks (e.g., when a local community decides to block business activities), increased political risks (e.g., if an FI is perceived as unsupportive of the government's development agenda), and reputational risks. Financing these disadvantaged groups is often challenging and can have a lower risk-return profile than other groups, even after accounting for public sector support. For those reasons, many FIs are actively looking for funding opportunities to improve their inclusiveness while meeting profitability targets. Climate finance presents an additional opportunity to advance inclusion objectives, but the teams internally driving the social sustainability agenda are often detached from climate finance conversations. Social inclusion teams need foundational capacity building to integrate climate finance effectively into their activities and align social and environmental strategies across the organization.

Lesson 4: Kick-start FI partnerships with quick wins that can open the door to multiple engagements and a durable relationship.

Due to time commitments and previous experiences with other climate actors, FIs can exhibit signs of "diagnostic fatigue" and have a limited appetite for relatively time-consuming assessments and co-creation initiatives with broad scopes, especially in the initial stages of a partnership. Where possible, it has proven beneficial to kick-start these partnerships with a streamlined rapid diagnostic (e.g., see example in the box below) and/or smaller and self-contained climate finance engagements that can quickly add value to the FI (e.g., highly technical assistance to meet specific climate finance needs). These interventions can often open the door to multiple engagement opportunities and the identification of self-reinforcing dynamics, resulting in a more robust and long-term relationship that can grow organically based on FI needs. Additionally, in delivering capacity building, it is often helpful to combine one-on-one and more tailored advisory sessions with group trainings where participants can learn from each other's experiences and potentially inspire less advanced FIs to act.

> USAID INVEST's Climate Finance Maturity Diagnostic developed in Colombia is a tool that provides a quick gap analysis to gauge each FI's climate finance needs and capabilities against four dimensions: strategy, portfolio development, measurement and reporting, and organizational change. It can be used to classify FIs within four maturity stages (exploring, aware, intentional, and transformative), determine capacity building needs, and identify pathways for transformation.

ACCELERATING ENVIRONMENT: FOSTERING EFFECTIVE INTERACTIONS BETWEEN FIS AND OTHER FINANCIAL ACTORS

For FIs to quickly and sustainably integrate climate finance as a long-term driver of the organization's growth and profitability, the 'enabling environment' for climate finance needs to become an 'accelerating environment'. Climate finance needs an integrated approach where other actors in the financial system (e.g., public sector regulators, third-party data providers, technical assistance providers, etc.) are all involved. FIs need support to interact more effectively with other actors in the financial system and better leverage their roles and capabilities.

Lesson 5: Improve access to climate-related data and analytical capabilities to integrate it into decision-making.

To assess their exposure to climate-related risks and financed GHG emissions, many FIs have expressed a need for technical assistance to upgrade their internal systems and capacity building to use and maintain these solutions (Lesson 1). Due to the limited data available from their borrowers, FIs need support to identify additional sources of climate-related data and incorporate analytical know-how to identify climate-related risks and opportunities, inform target setting, facilitate regulatory compliance, and conduct "stress tests" adjusted to regional climate-related risks. Available databases are often managed by public actors who need assistance to improve their quality, ease of use, and timeliness, sometimes even requiring full software upgrades. Similarly, FIs need training to be able to extract and incorporate available data into their current tools and analysis. FIs also need advice to explore alternative data sources that can be a reasonable proxy to estimate their exposure to climate-related risks and financed GHG emissions when data is either unavailable, incomplete, or unreliable.

USAID Business Egypt's capacity building efforts have increased FI demand for third-party data sources, data verification processes, and analytical best practices to incorporate data in their decision-making. Based on lessons learned from Egypt's Commercial International Bank, which is currently piloting PCAF tools to estimate financed emissions, the Activity is exploring providing technical assistance for an emission data gap analysis, benchmarking against GHG emission factors, and climate risk data sets (e.g., flood risk, soil salination, sea-level rise) relevant to Egypt's context.

Lesson 6: Build a two-way street between FIs and the public sector to accelerate climate finance integration.

In Egypt and Colombia, regulatory and reporting incentives have been one of the most critical drivers to encourage FIs to integrate climate finance into their operations. To accelerate this change and deepen its impact, the public sector is seeking to sharpen fiscal tools (e.g., reduce subsidies to highly polluting activities or make more accessible green tax incentives) and take on an expanded and more proactive role to facilitate climate finance. This could include becoming a convenor of financial institutions, project sponsor for public-private opportunities, or concessionary investor subsidizing insurance or guarantee costs. However, the public sector typically often lacks the know-how to take on these roles. FIs, through their senior leadership, are increasingly playing a more prominent role in advising the public sector and working with their public counterparts in designing these solutions. Banking associations can also position themselves as a key counterpart to the public sector on behalf of member FIs (e.g., offering a unified position on common green finance standards) and can influence their members in adopting relevant best practices (e.g., common tools to measure financed GHG emissions).

In 2022, the Central Bank of Egypt published a Sustainability Circular, which establishes guiding principles for banks to develop general frameworks for climate finance. The Central Bank's training arm, the Egyptian Banking Institute (EBI), then adopted a collaborative approach with the most influential national banks to jointly identify and address the financial sector's capacity building needs, development of key tools, and access to international finance, in partnership with USAID Business Egypt. This approach has been pivotal in encouraging increased FI demand for climate finance.

For more information on USAID's Sustainable Business Alliance and ongoing pilots, please contact:

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